BEFORE THE

SOUTH CAROLINA PUBLIC SERVICE COMMISSION

In the Matter of:		
South Carolina Electric and Gas Company's	)	
Application for an Increase in its	)	**Docket No. 2004-178-E**
Electric Rates and Charges	)	

DIRECT TESTIMONY

AND EXHIBITS

OF

RALPH C. SMITH

ON BEHALF OF THE

DEPARTMENT OF THE NAVY,
Utility Rates Analysis and Studies Office

October 18, 2004

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THE DEPARTMENT OF THE NAVY

Docket No. 2004-178-E

I. INTRODUCTION

Q. What is your name, occupation and business address?

A. My name is Ralph C. Smith, and my business address is 15728 Farmington Road, Livonia, Michigan 48154. I am a certified public accountant and a senior regulatory utility consultant with the firm of Larkin & Associates, PLLC.

Q. Have you previously presented testimony before the Commission?

A. Yes. I presented testimony before the Commission in a prior electric rate case involving South Carolina Electric and Gas Company ("Company" or "SCE&G") Docket No. 95-1000-E.

Q. Have you prepared an appendix that describes your qualifications and experience?

A. Yes. I have attached Appendix RCS-1, which summarizes my experience and qualifications.

Q. On whose behalf are you appearing?

A. The United States Department of the Navy representing the consumer's interest of the Department of Defense.

Q. Please describe the tasks you performed related to your testimony in this case.

A. I obtained and reviewed data and performed other procedures as necessary to (1) obtain an understanding of the Company's rate filing package as it relates to the issues I am addressing and (2) formulate an opinion concerning the reasonableness of amounts for issues I am addressing that are included within the Company's application for electric rate increases. In doing so, I examined SCE&G's filing, and requested and reviewed data and supporting calculations.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes. I have prepared one exhibit that is being filed with my testimony. Exhibit __(RCS-1) presents the adjustments I am recommending be made to SCE&G's proposed rate base and adjusted net operating income. Exhibit __(RCS-1) has six Schedules, one schedule for each adjustment.

Q. What issues will you be addressing in your testimony?

A. My testimony addresses these issues:

? The Company's request for retail rate recovery of GridSouth costs;

? An adjustment to reflect the 12 month average of Fossil Fuel Inventory in rate base;

? The Company's request to amortize into operating expenses an accrued liability for postemployment post-retirement benefits it recorded pursuant to Statement of Financial Accounting Standards ("FAS") No. 112;

? An adjustment to annualize test year operating expense in Account 924, Administrative and General Expense-Property Insurance;

? The Company's request for additional expense for new internal positions anticipated to be needed for compliance with new North America Electric Reliability Council (NERC) standards; and

? An adjustment for a levelized allowance for Other Major Maintenance Expense.

Q. Do you agree with all of the other pro forma adjustments proposed by SCE&G?

A. No. I have only addressed the specific issues listed here that were identified as significant to the Navy. As other parties, such as Commission Staff, Consumer Advocate, or other interveners raise issues and present testimony there may be other issues of significance to the Navy that come to light.

II. DISCUSSION AND ANALYSIS

1. The Company's request for retail rate recovery of GridSouth costs

Q. What is GridSouth?

A. GridSouth is the name of the prospective regional transmission organization ("RTO") that was in the process of being formed by SCE&G, Duke Power and Carolina Power and Light Company in response to directives issued by the Federal Energy Regulatory Commission ("FERC") in Order 2000.

Q. Did GridSouth become operational?

A. No. The project was suspended by SCE&G management following an order issued by FERC July 12, 2001, Carolina Power and Light Co. et al, 96 FERC 61,067 (2001). SCE&G's response to Consumer Advocate interrogatory 1-34 states that: "GridSouth never existed as an entity. No agreements between SCE&G and GridSouth exist." Additionally, the Company's response to Consumer Advocate interrogatory 1-31 states that the GridSouth board of directors was never seated.

Q. What has SCE&G proposed concerning retail rate recovery of GridSouth costs?

A. As explained in the direct testimony of SCE&G witness Carlette Walker, the Company proposes to amortize its investment in the GridSouth project over five years with a resulting increase in annual O&M expense of $2,819,193 and to include in rate base an amount of $7,047,982 representing the average amount of investment which will be reflected on the Company's books during the five year amortization period.

Q. Do you agree with this SCE&G-proposed adjustment?

A. No, for two separate reasons, I propose no change in O&M expenses or Rate Base for the Test Year to recognize GridSouth deferred expenses.

Q. Please explain your reasons for opposing the inclusion in retail rates of SCE&G's GridSouth costs at this time.

A. My first reason for opposing rate inclusion of such costs is that they are non-recurring. The ratemaking treatment of expenses can be described as an "either or" proposition. If an expense is non-recurring, it should be excluded from expenses and may be considered for recovery through amortization if it meets materiality and future benefit criteria. If an expense is an ordinary operating expense, it should be considered within the normalized level of expense for current rate recovery. The GridSouth expenses are clearly non-recurring because SCE&G does not attempt to form more RTOs on a regular recurring basis.

Moreover, these costs do not meet the traditional standards for deferred cost recovery. Amortization of a non-recurring cost may be appropriate if the expense is the result of a non-recurring event that has a significant adverse impact on the utility's financial condition. The GridSouth costs do not rise to such a significant level. In fact the approximately $14.1 million of deferred GridSouth costs SCE&G has accumulated through March 31, 2004 do not even rise to a level of materiality as they are less than 1 percent of SCE&G's annual operating revenues and less than ¼ percent of total assets.[1]

Another ratemaking principle that has been applied to evaluate whether non-recurring costs should be amortized into rates is the "future benefit" standard. Costs that have a future benefit to ratepayers can be amortized over a future period that corresponds to when the benefit is being realized. GridSouth start up costs and expenses may eventually meet this standard and be included in the FERC transmission tariff and allocated to the retail jurisdiction, but as of today, any possible future benefit to retail ratepayers is neither known nor measurable.

[1] SCE&G Exhibit D-1, page 4 of 7 shows total operating revenue of $1.881 billion and page 2 of 7 shows total assets of $6.331 billion.

The ratemaking standard of "used and useful" is also failed. There is nothing left of the prospective RTO except costs that have not been recovered by SCE&G. These costs never provided plant, goods or services used and useful in providing retail electric service to SCE&G customers.

Q. Is there also a jurisdictional problem with SCE&G's request?

A. Yes. My second reason for opposing SCE&G's request to include SCE&G's GridSouth costs in retail rates at this time relates to a jurisdictional problem. FERC Order 2000 prompted the creation of RTOs and GridSouth utilities were granted provisional authority for formation of the GridSouth RTO by the FERC on March 14, 2001. Later, when FERC required GridSouth to expand to be regional in scope, SCE&G management reacted by suspending the GridSouth project. Thus, both the impetus for expending funds and the suspension of the project did not come from this Commission's jurisdiction. The FERC transmission tariffs do not currently include these costs. Moreover, FERC has not approved inclusion in wholesale rates of the costs incurred by the Company related to the GridSouth RTO. As SCE&G explained in the response to Navy data request 1-7, "The Company has not sought approval of the FERC to include in wholesale rates the costs related to GridSouth." Nevertheless, SCE&G is seeking recovery of such costs from South Carolina PSC jurisdictional customers who did not create the circumstances that led to these costs. If the FERC does approve of these costs and include them in FERC tariffs, it would then be reasonable to permit allocation of appropriate transmission costs to the retail jurisdiction. In this instance, no such finding has been made by the FERC. Thus, allowing these costs to be recovered from retail customers is premature.

Q. Is your recommendation consistent with the Commission's ruling concerning SCE&G's request for retail rate inclusion of GridSouth costs in its last rate case?

A. Yes. In its last rate case, Docket No. 2002-223-E, SCE&G had requested retail rate inclusion of GridSouth costs. The Commission's discussion of this issue is contained on pages 14-17 of its January 13, 2003 Order No. 2003-238. Similar to the Commission's evaluation of this issue in Docket No. 2002-223-E, these concerns also are applicable in the current case and should produce the same conclusion:

? Most of the costs were incurred before the test year.

? The Company has not met its burden for recovery at this time.

? GridSouth was not operational during the test year and should not be considered used and useful during that time.

? FERC has made no determination of how it will treat GridSouth expenditures at the wholesale level.

These same factors that were applicable in Docket No. 2002-223-E concerning this issue continue to be applicable in the current case.

Q. Please summarize your recommendation concerning GridSouth costs.

A. SCE&G's proposal to include GridSouth costs in retail electric rates should be rejected in this proceeding for the ratemaking and jurisdictional reasons described above.

2. Fossil Fuel Inventory

Q. What has SCE&G reflected for Fossil Fuel Inventory in this case?

A. On Company Exhibit D-VI, page 1 of 2, line 2, SCE&G shows $26.945 million for Fossil Fuel Inventory, based an average year balances, and proposed to increase this by $23.340 million in its proposed Adjustment No. 19 to Adjust Fossil Fuel Inventory. SCE&G requested that $50.285 million of Fossil Fuel Inventory be included in rate base, as shown on Exhibit D-VI, page 1 of 2, line 3, of which $46.806 million is allocated to retail. SCE&G's Adjustment No. 19 reflected increases in the average coal quantity and the average cost of coal. On August 27, 2004, SCE&G filed a correction to its Adjustment No. 19, revising its October 2003 actual coal inventory amount and also revising its requested increase to $13.257 million and the total requested fuel inventory to $40.635 million. With this revision, the retail jurisdictional increase requested by SCE&G is $12.339 million and brings the retail Fossil Fuel Inventory that SCE&G proposes to $37.823 million.

Q. How was SCE&G's Fossil Fuel Inventory balance determined in its prior rate cases?

A. A 12-month average was used to determine SCE&G's Materials and Supplies balance, which includes Fossil Fuel Inventory, in its prior rate cases.

Q. Why is it appropriate to use a 12-month average to determine the Fossil Fuel Inventory balance to be included in rate base?

A. Since the balances for each component of Fossil Fuel Inventory, as well as the total, fluctuate from month to month, it is appropriate and more representative of normal experience to utilize an average balance for determining the rate base amount.

Q. What was SCE&G's average coal inventory for the test year?

A. For the test year ending March 31, 2004, SCE&G's average coal inventory was 685,237 tons or $21,786,644. In a revision filed August 27, 2004, SCE&G revised its October 2003 actual coal inventory amount, which increased the test year average coal inventory to $22,220,063. This is shown on Exhibit ___(RCS-1), Schedule 2, page 2. As shown there, based on the information provided in SCE&G's Response to Staff information data request 1-46, this represents a 38-days supply based on average forecasted burn and a 30-days supply based on maximum drawdown.

Q. Should an increase in the quantity of coal in inventory be allowed?

A. No. SCE&G's filing requested that it be allowed a rate base return on 925,000 tons of coal, on average. This represented an increase of 239,763 tons, or a 35 percent increase, over the actual test year average. SCE&G's August 27, 2004 update revised its requested coal inventory quantity to 708,333 tons, on average. This represents an increase of 23,096 tons, or 3 percent, over the actual test year average, shown in SCE&G's response to Staff data request 1-46.

The Company should not be allowed to earn a rate base return on a coal inventory that it did not actually have during the test year. Moreover, the test year average, which represents a 38-days supply based on average forecasted burn and 30-days supply based on maximum drawdown, is not unreasonably low. Consequently, there is no need to adjust the average test year quantity of coal inventory.

Q. Should the Fossil Fuel Inventory in rate base be increased to reflect higher coal costs?

A. No, and especially not as SCE&G has proposed.

Q. What was the average per-ton cost of coal inventory during the test year?

A. The average cost per ton during the test year was approximately $43.10, as shown on Exhibit ___(RCS-1), Schedule 2, page 2, based on the information SCE&G provided in response to Staff data request 1-46.

Q. Did the average per-ton cost of coal inventory increase during the test year?

A. Yes. During the test year, SCE&G's average cost per ton in coal inventory did increase, as shown on Schedule 2, page 2, and reached its highest point in February 2004, at $44.5862 per ton, and declined to $44.40 in March 2004.

Q. What cost per-ton for coal inventory does SCE&G propose using?

A. As shown in SCE&G's response to Staff data request 1-62, the per-ton prices SCE&G originally proposed ranged from the $45.78 (applied to May 2003) to the $51.74 (applied to February 2004). As shown on Exhibit ___(RCS-1), Schedule 2, page 2, the value for coal inventory that SCE&G originally proposed be included in rate base equated to approximately $48.79 per ton, which is $5.69 per ton or about 13.2 percent higher, than the test year average.

In SCE&G's August 27, 2004 update to its Adjustment No. 19, the Company has increased the per-ton cost of coal even higher than its previous proposal, and now proposes a per-ton cost of coal as much as $54.14 per ton for March 2004. As shown on

Exhibit ___(RCS-1), Schedule 2, page 2, the value for coal inventory that SCE&G now proposes be included in rate base equated to approximately $50.08 per ton, which is $6.98 per ton or about 16.2 percent higher, than the test year average.

The average coal prices SCE&G proposes are higher than the average cost of coal in inventory for any month in the test year ending March 31, 2004.

Q. Should the per-ton costs proposed by SCE&G be used to compute the coal inventory in rate base?

A. No. The fossil fuel inventory should not be adjusted for fluctuations in the unit price of coal that may have occurred subsequent to the test year. The higher per-ton prices proposed by SCE&G were not effective during the test year, lack support, and should not be used.

Q. If the Commission wanted to adjust coal inventory for the price increases experienced during the test year, what would you suggest?

A. I am not proposing an increase to the average coal price for computing the Fossil Fuel Inventory to be included in rate base. However, if a higher-than-average test year per-ton coal price is used to compute a rate base adjustment, it should be limited to the $44.40 per ton based on SCE&G's actual March 2004 coal inventory.

Q. What was SCE&G's March 31, 2004 coal inventory, and how does your recommended level compare with it?

A. SCE&G's actual March 31, 2004 coal inventory was $15,923,397, as shown on the Company's response to Staff data request 1-62. My recommendation of using the average test year coal inventory, as corrected by SCE&G, of $22,220,063 is $6,296,666, or 39.5 percent, higher than this end-of-test-year balance.

Q. What adjustment do you recommend for Fossil Fuel Inventory?

A. I recommend using the actual test year average for Fossil Fuel Inventory without adjustment for higher coal inventory quantities or coal cost increases that were not experienced during the test year, as shown on Exhibit RCS-1, Schedule 2.

3. Long-Term Disability (FAS 112) Amortization

Q. What is SCE&G's requesting in its proposed Adjustment No. 9?

A. As described in SCE&G witness Walker's testimony at pages 12-13, in this adjustment SCE&G proposes to amortize over five years an $8.3 million liability that it accrued pursuant to Statement of Financial Account Standards No. 112 ("FAS 112") associated with its long-term disability program. SCE&G deferred these costs in a regulatory asset account and its proposed amortization would increase test year O&M expenses by $1,656,094.

Q. What is FAS 112?

A. This accounting standard, issued in November 1992 and applicable for financial reporting purposes in 1994, represented the final phase of the Financial Accounting Standards Board's ("FASB") project on employers' accounting for pensions and other postretirement benefits. FAS 112 covers benefits provided by the employer to former or inactive employees after employment but before retirement.

If FAS 112 requirements[2] are met, employers must accrue post employment benefit costs as they are earned. For financial reporting purposes, FAS 112 required companies to recognize the cumulative effect of switching to the accrual method of accounting for post employment benefits, or their post employment benefit obligation. The post employment benefit obligation, according to FAS 112, must be recognized in its entirety at the date of adoption.

Q. Does SCE&G prepare an actuarial report for FAS 112?

A. No. Unlike pensions (FAS 87) and non-pension postretirement (health) benefits (FAS 106), no actuarial report for postemployment (long-term disability) benefits per FAS 112 was prepared by SCE&G, as stated in the Company's response to Navy interrogatory 1-4.

Q. Do you agree with the adjustment proposed by SCE&G?

A. No. SCE&G has failed to show how an amortization of the FAS 112 post employment benefit obligation is relevant or appropriate to the test year ending March 31, 2004. While it does appear that SCE&G recorded a deferral on its books for the FAS 112 post-employment benefit obligation, the deferred debt and credit balances on SCE&G's books as of March 31, 2004 relating to this item are equal, indicating that there is no net amount that would be required to be amortized into future expense for ratemaking purposes. In response to Staff information request 1-62, SCE&G shows that its total FAS 112 postemployment benefit obligation, which relates to long-term disability, is $11.004 million.[3] In response to Staff information request 1-52, SCE&G shows that it has recorded equal and offsetting balances of $11.004 million for Long Term Disability in Other Regulatory Assets and Other Deferred Credits:

Long Term Disability at 3/31/04	Amount
Other Regulatory Assets	$ 11,004,000
Other Deferred Credits	$ (11,004,000)
Net	$ -

Amortizing SCE&G's March 31, 2004 credit and debit balances for Long Term Disability that were recorded pursuant to FAS 112 over the same five-year period would produce a net result of zero.

Q. Does SCE&G appear to rely on any order from the Commission for deferring its expense associated with implementing FAS 112 into an Asset account?

A. No. Based on discussions with an SCE&G representative, the Company has no accounting order or other authorization from the Commission to treat the FAS 112 expense as a regulatory asset. The Company's only apparent basis for recording $11.004 million into a regulatory asset account is that it was intending to seek recovery in rates of the retail electric portion of this cost in the instant rate case.

Q. Was SCE&G asked in a data request to identify any Statement of Financial Accounting Standards (SFAS) that was implemented during the test year?

[2] These requirements are: (1) the employers' obligation relating to employees' rights to receive post employment benefits is attributable to employees' services already rendered; (2) the obligation relates to rights that vest or accumulate; (3) payment of post employment benefits is probable; and (4) the amount can be reasonably estimated.

A. Yes. Staff data request 1-85 asked SCE&G to:

> "Identify any Statement of Financial Accounting Standards (SFAS) that was implemented during the test year. For each SFAS identified please quantify the effect on test period revenues, expenses and rate base items."

Q. What SFAS were identified by SCE&G in response to Staff data request 1-85?

A. SCE&G's response to Staff data request 1-85 identifies SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," and Financial Accounting Standards Board Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities." Notably, there is no mention by SCE&G in its response to Staff data request 1-85 of SFAS 112. SFAS 112 was required to be followed for fiscal years beginning after December 15, 1993. Clearly, SFAS 112 was not an accounting standard that should have had initial implementation during the test year ended March 31, 2004.

Q. Has SCE&G demonstrated how much of the $11.004 million relates to the test year, and how much relates to periods prior to the test year?

A. No. SCE&G has not demonstrated how much, if any, of the $11.004 million was expense incurred during the test year, as opposed to the cumulative effect of adopting FAS 112, that is attributable to prior years and which SCE&G probably should have recorded in prior years as the expense was incurred. As noted above, FAS 112 was required to be adopted by 1994. Moreover, FAS 112 required expensing the cumulative effect of FAS

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[3] Of this, SCE&G shows its electric amount is $8,280,470.

112 adoption in the initial year of adoption. We are now in 2004, almost ten years after the required date of adoption of FAS 112. Based on the information provided by SCE&G, a prospective amortization of the cumulative effect of adopting FAS 112 is not a valid or appropriate expense to included in the test year ending March 31, 2004.

Q. Is it generally appropriate to include in the test year, expenses which are attributable to prior years and/or which should have been accrued in prior years?

A. No, it is not.

Q. What is the basis for the five-year amortization period proposed by SCE&G?

A. SCE&G's filing does not offer a rationale for the proposed five-year amortization period and thus it appears to be arbitrary. FAS 112 relates to cost for inactive employees who are not currently rendering service to the employer and who have not been terminated, including those who have been laid off and those on disability status, regardless of whether they are expected to return to active status. Consequently, the period between when an employee becomes inactive, but before that employee reaches retirement, should be one factor to examine in assessing the reasonableness of SCE&G's proposed amortization period.

Q. How does the amortization period proposed by SCE&G relate to the period between when an employee covered under FAS 112 becomes inactive but before that employee reaches retirement?

A. Again, this is not clear from SCE&G's filing.

Q. Has SCE&G already included long-term disability expense in test year operating expenses, before its request for additional expense for FAS 112 in Adjustment No. 9?

A. Yes. In calculating annualized test year benefits, in its Adjustment No. 7, SCE&G included test year long-term and short-term disability expenditures of $2,487,770 and $2,956,359, respectively, in deriving its "benefits-to-total-payroll" percentage of 7.86% and its proposed increase in employee benefits expense of $474,482. Thus, SCE&G has already reflected both short and long-term disability expense in test year operating expenses, and has even reflected an increase in disability benefits cost in its Adjustment No. 7 before proposing additional and duplicative disability expense in Adjustment No. 9. SCE&G's proposal for additional disability expense in its Adjustment No. 9 would result in improperly loading into the test year excessive amounts of disability expenses that were not incurred in the test year and would result in charging ratepayers for disability expenses beyond normal recurring levels.

Q. What adjustment do you recommend?

A. As explained above, there is no basis for increasing test year expense for an amortization of FAS 112 costs. SCE&G has not supported why the $11.004 million amount shown in its response to Staff data request 1-62 was accrued in the test year when FAS 112 was required to be implemented in 1994. Also, SCE&G has not demonstrated how much, if any, of the accrual relates to test year cost, as opposed to costs incurred in prior periods. Additionally, as far as I could ascertain, SCE&G has neither sought nor received, prior to its current rate case filing, any Commission authorization for deferring the cumulative impact of initial implementation of FAS 112 into a regulatory asset account for a potential future amortization. Nor has SCE&G supported its proposed amortization period. Consequently, for all of the reasons explained in my testimony, SCE&G's proposal to increase test year expense by $1.656 million for a FAS 112 amortization in Adjustment No. 9 should be rejected.

4. Annualize Account 924, A&G Expense-Property Insurance

Q. Please explain your adjustment to annualize the test year expense in Account 924, Administrative and General Expense – Property Insurance.

A. This adjustment annualizes the expense in Account 924, Administrative and General Expense – Property Insurance to the year-end levels. During the test year SCE&G recorded $3,325,963 expense in Account 924. An analysis was performed of the test year entries recorded in this expense account. As shown on Exhibit __(RCS-1), Schedule 4, page 2, on average, the monthly amounts have decreased.

Q. Has SCE&G explained why some of the decreases to insurance expense in the test year have occurred?

A. Yes. As illustrative examples, SCE&G's response to data request Navy 2-18 stated:

> "Effective in November 2003, SCE&G began self-insuring for losses on contractor equipment resulting in a reduction to the Industrial operating expenses of $359/month. Property insurance for the Industrial SBU was reduced approximately $2,000/month beginning in November 2003."

Similarly, SCE&G's response to data request Navy 2-25 stated:

> "Effective in November 2003, SCE&G began self-insuring for losses on contractor equipment resulting in a reduction to the Retail SBU's operating expenses of $265/month. Property insurance for the Retail Electric SBU was reduced approximately $5,500/month beginning in November 2003."

Annual premium amounts provided in SCE&G's response to data request Navy 2-7 indicate a reduction of $138,895 in the all risk policy premium from $2,995,669 in the November 2002 renewal to $2,856,774 in the November 2003 renewal. A portion of this annual premium is assigned by SCE&G to capital overheads and to SCE&G's gas operations. Additionally, an October 2002 contractors equipment insurance policy was discontinued as of October 2003, such that no premiums for such policy were being subsequently incurred. The 2002 Policy cost $32,085 and was included in the test year ending March 31, 2004 (before reflecting an assignment of a portion to SCE&G's gas operations).

In summary, there have been known decreases in SCE&G's insurance expense that occurred during the test year, which should be reflected for ratemaking purposes.

Q. What adjustment do you recommend?

A. As noted above, and shown on Exhibit __(RCS-1), Schedule 4, page 2, SCE&G's monthly insurance expense decreased during the test year. Using March 2004 expenses for this account, which has experienced a downward trend during the test year, reflects year-end conditions and would be more appropriate for a going forward level than the recorded test year expense. After accounting for $501 of employee travel expense that SCE&G recorded in this account during the test year, annualizing the March 2004 expense produces an annual expense allowance for Account 924 of $3,172,413. This is $154,810 less than the recorded test year amount. As shown on Exhibit __(RCS-1), Schedule 4, page 1, the adjustment to decrease retail electric expense is $148,308.

5. New Internal Positions for Compliance with New NERC Standards

Q. Please explain your adjustment for new internal positions proposed by SCE&G for compliance with new North American Electric Reliability Council (NERC) Standards.

A. This adjustment removes the projected expense for 8 new internal positions and benefits that SCE&G proposed as part of its Adjustment 13C. SCE&G has not supported its proposed use of average annual salary amounts for new employees. Also, SCE&G has not supported that it has actually hired 8 additional positions. This SCE&G proposed adjustment does not meet the known and measurable standard and should therefore be removed. As shown on Exhibit __(RCS-1), Schedule 5, SCE&G's proposed pro forma addition to test year expense is reduced by $870,000. The adjustment decreases SCE&G's proposed retail electric expense by $818,844.

6. Levelized Allowance for Other Major Maintenance Expense

Q. Please explain your adjustment to provide a levelized allowance for SCE&G's Other Major Maintenance Expense.

A. This adjustment reduces SCE&G's proposed amount for two adjustments:

(1) to reflect current value dollar amounts of the future year expenditures used by SCE&G in its proposed Adjustment No. 5; and

(2) to reflect five years as the initial "trial" period for the levelization, rather than the eight years proposed by SCE&G.

Q. Why should the projected future year amounts be discounted to current dollars?

A. The concept of present value indicates that future cash flows be discounted to current dollar value so the current impact can be determined. Other things being equal, a dollar in hand today is worth more than a dollar in hand one year from today, because the dollar could be invested to earn a return. Assuming a 10% rate of return, $1.00 today would be worth $1.10 a year from today. Conversely, at a 10% discount rate, $1 a year from now has a current value of about 91 cents.

Q. What discount rate did you use in your calculation?

A. For simplicity purposes, I used an annual discount rate of 10%. While I am not suggesting that SCE&G requires or should be granted an increase in its overall rate of return, I note that a 10% discount rate is also close to the 9.94% return on retail electric rate base that the Commission authorized for SCE&G in its Order No. 2003-38. If the Commission determines that a significantly different rate of return is appropriate in the instant case, the calculation can be easily adjusted to reflect an alternative discount rate.

Q. What is SCE&G's reason for selecting an eight-year projection period for the levelization mechanism?

A. SCE&G's response to Staff data request 1-62 states that: "The accrual mechanism covers an eight year time frame because the major maintenance activities for the 7FA gas turbines at the Jasper and Urquhart Generating Stations are estimated to be completed during this time period."

Q. Why do you recommend using only five years rather than the eight proposed by SCE&G?

A. The period 2005 through 2009 includes substantial maintenance at Urquhart and Jasper, and should therefore be fairly representative of high and low years. The Company's estimates of future maintenance may be less reliable as the projection period is extended further out into the future. Additionally, the levelization proposal is a new program and the reliability of SCE&G's projected maintenance estimates should be subject to review in SCE&G's next rate case. While we do not know when SCE&G's next rate case will be, based on the Company's recent history of filing, it seems more likely that it would be within five years, as opposed to eight years.

Q. Do you have any other recommendations related to the SCE&G Major Maintenance program?

A. Yes. I recommend that SCE&G report to the Commission on its actual versus projected expenditures, and that any over-collected balance at the end of the five-year "trial" period be refunded to ratepayers.

Q. What dollar adjustment are you proposing with respect to the levelized allowance for other major maintenance?

A. As shown on Exhibit __(RCS-1), Schedule 6, SCE&G's proposed average annual accrual of $8,463,910 should be reduced by $2,855,902 to provide for an annual levelized allowance in current dollars of $5,608,008.[4] Retail electric expense proposed by SCE&G is reduced by $2,658,273.

Summary of Adjustments

Q. Please summarize your recommendations.

A. My recommendations are summarized as follows:

1. The Commission should reject SCE&G's proposal to have South Carolina jurisdictional customers pay for costs and expenses related to GridSouth that were generated because of FERC actions, but not included in FERC tariffs.
2. The Commission should reduce SCE&G's August 27, 2004 updated Rate Base by $13.257 million to recognize test year average fuel inventory balances.
3. The Commission should reject SCE&G's proposal to increase test year O&M expense by $1.658 million for the amortization of a long-term disability accrual relating to the implementation of FAS 112.
4. The Commission should reduce test year expense by $154,810 to annualize the expense in Account 924, Administrative and General Expense – Property Insurance to the end-of-test year level.
5. The Commission should reduce test year expense by $870,000 for 8 new positions proposed by SCE&G for compliance with new North American

[4] The allowance in nominal dollars is $7,344,243.

Electric Reliability Council Standards because SCE&G's Adjustment 13C does not meet the known and measurable standard with respect to the actual salary costs or the actual hiring of the proposed new employees.

6. The Commission should reduce the pro forma expense proposed by SCE&G for a levelized recovery program for Other Major Maintenance Expense by $2,855,902 to reflect the application of a discount rate for future year projected amounts and to reflect a five-year period, rather than the eight-year period proposed by SCE&G.
7. If the Commission adopts a levelized recovery program for Other Major Maintenance Expense, it should require SCE&G to report on its actual versus projected maintenance expenses covered under the program, and if there is an over-collected balance at the end of the five-year "trial" period, provision should be made for SCE&G to refund the over-collection to ratepayers.

Q. Does this complete your testimony?

A. Yes, it does.